



**Forecast Summary: “As growth of the national economy and the New Jersey economy slows, the Governor’s Economic Growth Strategy could not be more important, nor more timely.” Dr. Joseph J. Seneca**

## New Jersey Summary

New Jersey’s core economy remains robust and impressive. Employment is at an all time record (4,080,700 jobs as of August 2006). The state has the highest median household income in the nation (\$61,672), which supports a strong consumer economy. The state’s international trade sector is thriving with exports 20% higher than a year ago. A large logistics and warehousing sector provides significant employment and income supporting the movement of goods into and out of New Jersey. Job growth in 2006 to date has been strong in business and professional services, leisure and hospitality, and educational and health services, although manufacturing and information continue to lose jobs.

However, the growth of the national economy has decelerated significantly since the first quarter of 2006. New Jersey has felt this slowdown in an even more pronounced way. Its employment growth for the year is likely to be well below the earlier forecast of 1%, and both the slower rate of growth in jobs and the composition of that growth (primarily in below-average-pay sectors) remain serious concerns. Income growth has been steady (4.1% from the 4th quarter of 2005 to the 2<sup>nd</sup> quarter of 2006, and exceeded the national growth rate (3.9%). However, income growth is likely to moderate in the second half of the year. The housing sector, a major source of strength for New Jersey over the past several years, has now experienced a marked slowdown. The outlook is for further deceleration in economic growth as national economic conditions soften and international and inter-state competition for economic development intensifies. Given the context of a slowing economy and increasing competition, Governor Jon Corzine’s Economic Growth Strategy to improve the state’s economic performance is both vitally important and extremely well-timed.

**Summary: New Jersey Forecast (% Change)**

	2005	2006
Gross State Product (Current \$, bill)	5.0%	5.1%
Personal Income (Current \$, bill)	5.0%	6.1%
Retail Sales (Current \$, bill)	4.8%	4.9%
Consumer Price Index (All Urban)	3.9%	3.8%
Total Non-Ag Employment	1.1%	0.6%

### Governor Corzine’s Economic Growth Strategy: Right target and Right time!

Early in September, Governor Jon Corzine released his Economic Growth Strategy, a comprehensive and multi-faceted plan designed to grow the economy. Led by Gary Rose, Director of the Office of Economic Growth, the plan was the product of extensive discussions with the business community. With the national economy slowing, and New Jersey’s labor markets more than echoing that slowdown, the Governor’s growth strategy is both important and timely.

The key element of the plan is the explicit affirmation that improving the performance of the state’s economy is the highest priority of the administration and that the Governor will provide the leadership to make this happen.

The plan contains several new programs to invest in the state’s economy on a sustained and significant basis. First, the Edison Innovation Fund will provide \$500 million in state and private resources to make strategic investments in science and technology industries and increase commercialization and technology transfer from the state’s research universities. Second, a New Jersey Urban Fund of \$555 million in state and private resources will make infrastructure and economic development investments. Additional public investments in transportation and other infrastructure will be coordinated across the state agencies and authorities with a goal of increasing foreign trade and the efficiency of the state’s ports, both areas of significant economic strength.

The plan also has comprehensive components to increase workforce development and the effectiveness of math and science education. Both are critical to improving the long-term competitiveness of the state’s economy.

Continued assessment of New Jersey’s high taxes, regulatory structure, and high costs of doing business is required, and appropriate changes must be made in order to maintain the state’s competitiveness.

The Governor’s Economic Growth Strategy sends a clear and forceful message, backed by resources and careful planning, that economic development is a priority and that the Governor is committed to ensuring that New Jersey remains an attractive place to work and live, and a competitive place for businesses to locate and expand.



## The U.S. Economy

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The national economy had a break-out performance in 2004 and 2005 when over 2 million jobs were added each year. During that time, real Gross Domestic Product grew by over 3% each year. Inflation and interest rates remained low and the housing market and consumer spending continued to be growth engines. Moreover, this strong economic performance continued into the first quarter of 2006. Indeed, through March, the nation was on a pace to add another 2 million jobs for the year, and the first quarter's growth in real GDP was a robust 5.6!

Since then, however, national economic growth decelerated markedly. The rate of job growth fell from its 2 million per year pace of the first quarter to a much lower 1.3 million rate. Growth of real GDP in the second quarter slipped to 2.6% and core inflation accelerated. As a result, the Federal Reserve finds itself in a tighter quandary as it seeks a balance between tapping the monetary brakes to avoid an acceleration in inflation, but not so hard as to stall economic growth. There was a sharp turnaround in the housing sector, that former Energizer bunny of economic activity that just kept going, and going, and going during the first half of the decade. Housing has now become a drag on the economy. The key cause of the turnaround was the steady deterioration in affordability as the relentless increase in house prices, particularly on the east and west coasts, outstripped income gains. In addition, mortgage rates have risen with the FED's rate tightening policy.

The consensus forecast is for real GDP to increase in the 2% to 2.5% range in the second half of 2006 and to remain in that range for 2007. The likelihood of a recession is low, barring a severe shock, as the housing sector continues to unwind in an orderly fashion. A major concern is the possibility that home prices decline over a widespread geographic area of the country on a sustained basis and cause a substantial negative impact on consumer spending.

The energy price roller coaster of 2006 reminds us that energy continues to be a wild card going forward. The recent sharp declines in energy prices are most welcome news for consumer purchasing power and will certainly help in the FED's ongoing and preemptive fight against inflation. But the volatile nature of energy markets makes the recent decline a positive, though fragile, change for the economic outlook. Exports

continue to be a bright spot, and there has also been an increase in business investment spending. These two sectors are expected to offset the slowdown in housing and consumer spending. Employment and wage and salary income growth have moderated, although higher interest income and the exercising of stock options have boosted total personal income growth.

## N.J. Employment Profile

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Job growth in the nation and in New Jersey slowed considerably in 2006 to date, with the slowdown more pronounced in New Jersey. From December 2005 to August 2006, payroll employment in New Jersey rose by 16,200 jobs. That rate of increase over eight months, if sustained for the rest of the year, would result in a gain of approximately 25,000 jobs for all of 2006. This total would be significantly below the increase of 46,000 jobs in 2005 (December 2004 to December 2005). The private sector added 12,000 jobs through August, for an estimated annual gain of 16,000 new jobs for all of 2006. This is considerably below the 42,900 private sector job increase in 2005. By comparison, the national increase in private sector jobs from December 2005 through August 2006 was 0.9% versus a 0.3% gain in New Jersey.

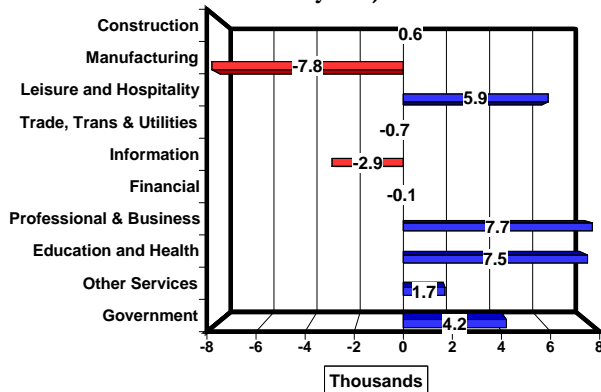
In terms of business sectors, the private service-providing sector added 19,100 jobs through August with noteworthy increases of 7,700 jobs in professional and business services, 7,500 jobs in education and health services, and 5,900 jobs in leisure and hospitality. Job losses occurred in manufacturing (-7,800 jobs) and information (-2,900 jobs). Both of these sectors, which are above-average-pay sectors, have been subject to intense competition over a sustained period. The recent opening of Verizon's operational headquarters in the former AT&T site in Somerset County is a welcome sign of New Jersey's continued appeal to telecommunications companies despite the negative effects of deregulation and profound technological changes that have adversely affected the wired component of the industry in the state. Total manufacturing employment in New Jersey in August 2006 was 315,400 jobs, or 7.7% of total payroll employment in the state. Nationally, manufacturing employment accounts for 10.4% of all employment.

Construction employment grew slightly through August (600 jobs), and remains near its all time high. Public sector employment increased by 4,200 jobs.

# New Jersey Mid-Year Economic Review & Outlook 2006



**NJ Employment Change (000) by Sector,  
December 2005 to August 2006  
(Absolute number)  
Seasonally Adjusted**



The increase in New Jersey's unemployment rate over the year has been worrisome. In August 2006, the unemployment rate in New Jersey was 5.3%, or 0.9% points higher than in August 2005. Most of that increase was attributable to an expansion of the labor force (more people looking for work), but nevertheless, the increase was counter to the trend in the nation and most states over this time. The Bureau of Labor Statistics household survey, which is the basis of the unemployment rate data, indicated that New Jersey's labor force increased by 49,100 people, that employment rose by 9,800 jobs, and therefore, that unemployment increased by 39,300 between August 2005 and August 2006. Thus, the two BLS surveys – payroll and household – both point to a noticeable slowdown in New Jersey's labor markets in 2006 to date. It is noteworthy that the household survey, which includes self-employment, contract employment, and New Jersey residents working out-of-state, indicates only very modest employment growth on a year-over-year basis (as of August 2006).

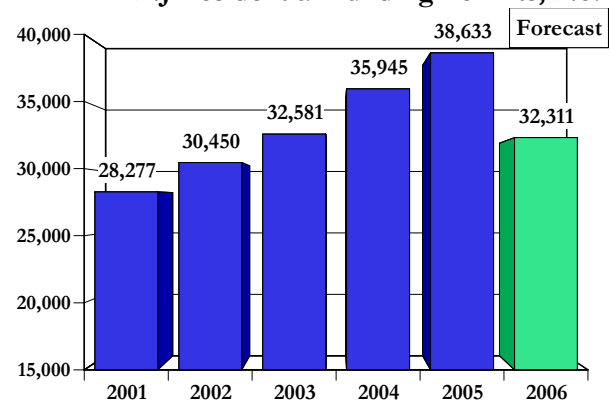
## Personal Income and Spending

Income continued to grow strongly in New Jersey. The latest data available indicate that through the second quarter of 2006 (i.e. from 4<sup>th</sup> quarter 2005 to 2<sup>nd</sup> quarter 2006), total personal income increased by 4.1 % in New Jersey. In comparison, personal income rose 3.9% nationally. In terms of regional income growth, New Jersey outpaced both Pennsylvania (3.7%) and New York (3.9%). Of concern, however, is the *relatively* slower growth in wage and salary income and supplements to wages and salaries in New Jersey (4.5%) compared to the nation (4.8%). This differential reflects the slower

employment growth in New Jersey over the past several years and the composition of that growth, which has been dominated by job gains in below-average-pay business sectors. On the positive side, it is also noteworthy that income attributable to dividends, interest and rent grew faster in New Jersey (4.2%) than in the nation (3.3%), and that proprietors' income also grew more rapidly in New Jersey (2.5%) than in the nation (1.4%). Wage and salary income and supplements to it, however, are the largest components of total personal income (64% in New Jersey, and 69.1% nationally). Income growth has slowed in 2006 in both New Jersey and the U.S. Income grew at a 2.4% rate from the last quarter of 2005 to the first quarter of 2006 in New Jersey, and then slipped to a 1.7% growth rate from the first quarter to the second quarter. The equivalent changes for the U.S. were 2.2% and 1.7%.

The national housing sector slowdown is also apparent in New Jersey. On a year-to-date basis as of May, residential building permits are 17.7% below the same period of 2005. Contract sales (of both new and existing homes) on a year to date basis as of August 2006 are down 19% from the same period a year ago. In addition, unsold housing inventory is up a very large 60%. House price appreciation has slowed markedly, and in some local New Jersey markets, prices have fallen. The outlook is for continued weakness in housing with dampening implications for related consumer spending on furniture, furnishings, appliances, and other home product durable goods.

**NJ Residential Building Permits, No.**



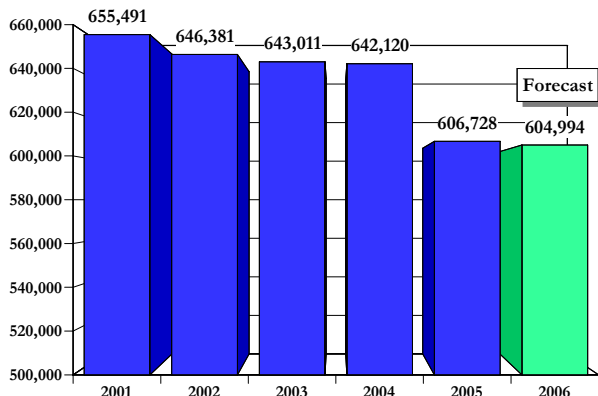
New vehicle registrations held up over the first five months of 2006, but the data did not yet reflect a very slow summer season of sales and the effects of volatile changes in gas prices. Intense competition, dealer incentives, and changes in consumer preferences due to gas price spikes all make the motor vehicle

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industry subject to sharp swings in sales on a month to month basis. However, the overall slowdown in employment growth, higher interest rates, and roller coaster gas prices, point to a further decline in vehicle sales.

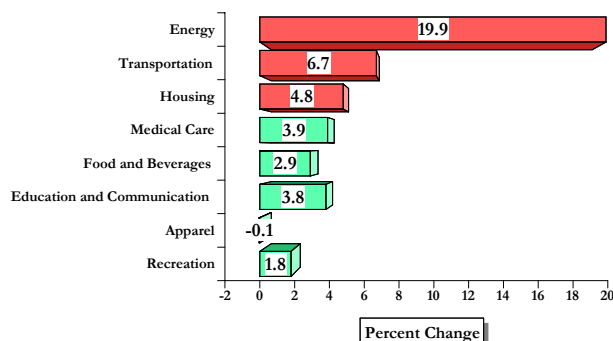
**NJ New Vehicle Registrations**



## Consumer Prices

The developing economic problem nationally in 2006 has been the dual presence of a slowing economy and rising inflation. This same pattern has occurred in New Jersey. The inflation rate in New Jersey, based on the NY/NJ consumer price index, increased by 4.2% in 2006 year to date as of July compared to the same period last year. This represents an increase of .3 percentage points over the 3.9% inflation rate of 2005.

**NY/NJ Consumer Price Index, by Expenditure Category, % Change, 2006 YTD Vs. 2005 YTD**  
All Items = 4.2 %



The major component of the increase was a staggering 19.9% rise in energy costs. However, the data are only available as of July and the recent sharp decline in energy prices will lower this component of the CPI significantly. Other major price component increases were: transportation, 6.7%; housing, 4.8%; medical care

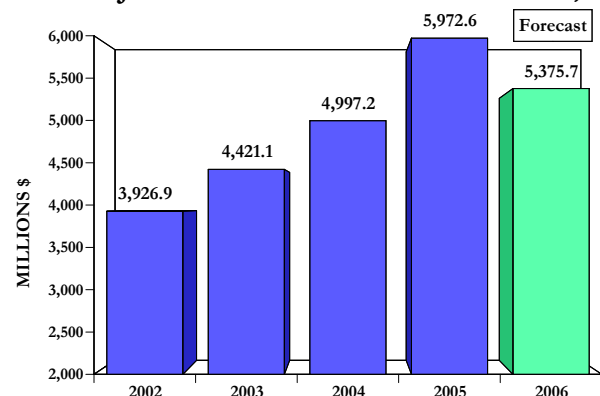
3.9%; education and communication, 3.8%; and food and beverages, 2.9%.

The national outlook is for inflation to moderate in 2007 with the caveat that the volatility of energy costs remains a wild card in the outlook. Certainly the sharp swings in energy costs experienced to date in 2006 raises caution about the reliability of any inflation forecast going forward. Other recent concerns with respect to inflation are the above-trend increase in unit labor costs and the decrease in the rate of growth of labor productivity.

## Investment in New Jersey

Although recent data indicate a marked slowdown in housing, the value of residential contracts held up well during the first half of 2006. From January to June 2006, residential construction contracts were 3.3% above the level for the same period a year ago. However, the continuing deceleration in the housing market is expected to result in a much slower second half and the overall level of 2006 by year's end will likely be significantly below last year's total.

**NJ Residential Construction Contracts, \$**



At the national level, there has been a significant increase in non-residential business investment in 2006. In New Jersey, non-residential construction contracts during the first half of the year are slightly above (2.3%) last year's pace. However, there was a strong gain (21%) in 2005 over the previous year and the expectation is that the level of non-residential contracts will retain those gains in 2006. However, the vacancy rate in Class A office space remains high – 18.8% in the 11 county North and Central New Jersey area – and this continues to dampen the commercial office space market. However, there has been a net absorption of 1.2 million

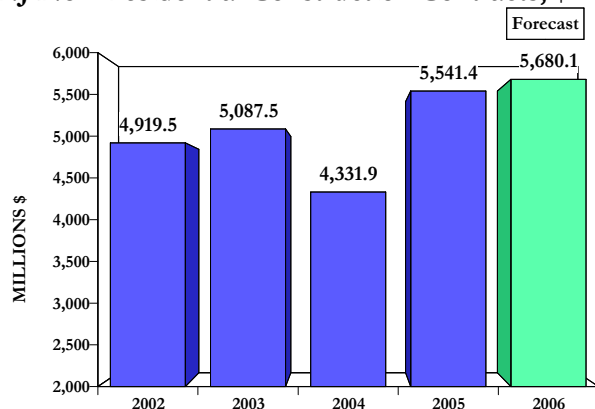


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square feet of vacant Class A space through the second quarter of 2006.

## NJ Non-Residential Construction Contracts, \$



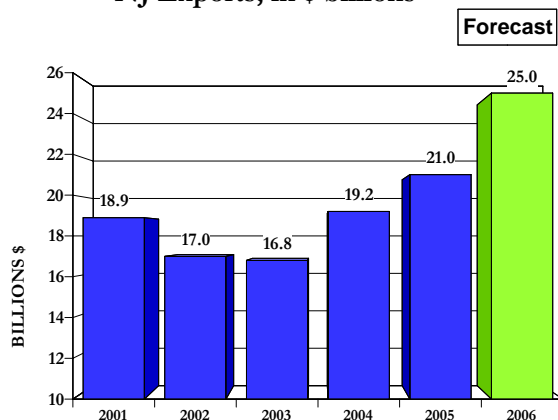
New Jersey ports received a record amount of cargo in the first half of 2006. This is due to changes in international trade shipment routes, congestion in West Coast ports, and increases in overall import levels into the U.S. The latter is reflected in the estimated \$700 billion trade deficit for the U.S. in 2006, which has serious long run national economic implications. In the first six months of 2006, Port Elizabeth handled 1.8 million cargo containers, up from 1.6 million a year ago! It is estimated that the logistical support required to receive, store, and transport such enormous volumes of cargo generates over 250,000 jobs in the state. As competition for international cargo increases, especially from ports in the American South, it is critical that New Jersey provide the state of the art infrastructure to maintain the cost competitiveness of its ports.

## International Trade

New Jersey has benefited significantly from the increase in international trade both as an exporter and as a major hub for the receiving and distribution of imports. This sector will continue to be a source of strength for New Jersey as a result of the positive economic and employment impacts of private and public investment in warehousing, distribution, and transportation infrastructure.

New Jersey exports grew by a robust 24% in the first six months of 2006 compared to the same period a year earlier. Exports for all of 2006 will set an all time record of \$25 billion. Expected further weakness of the dollar in foreign exchange markets will continue to improve the competitiveness of American goods and services in international trade and benefit New Jersey exports. Major export categories for New Jersey include industrial machinery, organic chemicals, pharmaceutical products and electrical machinery.

## NJ Exports, in \$ billions



## NJ COUNCIL OF ECONOMIC ADVISORS

About the Council of Economic Advisors: Established by law in 1993 (P.L. 1993, Chapter 149).

The Council is an advisory organization reporting directly and independently to the Executive branch of government, the Legislature and the public.

The Council prepares an Annual Report and a mid-year Report analyzing current New Jersey economic conditions and forecasting future developments, assists the Governor's Office in the preparation of the annual budget message, and advises the Governor and Legislature on public policies affecting the State's economy.

The Council consists of a Chairman appointed by the Governor and several legislative appointees.

### The Council members are:

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<i>(Current \$ or Nos.)</i>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	Forecast <u>2006</u>
Gross State Product (bill \$)	362.3	372.7	388.6	410.3	430.8	452.7
Personal Income (bill \$) <sup>1</sup>	333.0	337.8	343.4	363.8	382.0	405.3
Retail Sales (bill \$)	105.0	106.7	109.4	116.1	121.7	127.6
New Vehicle Registrations (000)	655.5	646.4	643.0	642.6	606.7	604.9
Non-Res. Construction Contracts (mill \$)	5,017.6	4,919.5	5,087.5	4,331.9	5,541.4	5,680.1
Residential Building Permits (No.)	28,277	30,450	32,581	35,945	38,633	32,311
Res. Construction Contracts (mill \$)	3,885.7	3,926.9	4,421.1	4,997.2	5,972.6	5375.7
CPI (1982-1984=100) <sup>2</sup>	187.1	191.9	197.8	204.8	212.7	220.8
<b><i>Employment</i><sup>3</sup></b>						
Total Nonfarm (000)	3989.0	3970.5	3983.6	4018.5	4064.5	4089.5
Manufacturing (000)	381.9	358.3	344.4	334.3	323.2	315.4
Private Service-Providing (000)	2828.7	2833.8	2852.1	2875.4	2926.1	2955.3
<b>Percentage Change from previous year:</b>						
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	
<b><i>(Current \$ or Nos.)</i></b>						
Gross State Product	2.9	4.3	5.6	5.0	5.1	
Personal Income	1.4	1.7	5.9	5.0	6.1	
Retail Sales	1.6	2.5	6.1	4.8	4.9	
New Vehicle Registrations	-1.4	-0.5	-0.1	-5.6	-0.3	
Non-Res. Construction Contracts	-2.0	3.4	-14.9	27.9	2.5	
Residential Building Permits	7.7	7.0	10.3	7.5	-16.4	
Res. Construction Contracts	1.1	12.6	13.0	19.5	-10.0	
CPI (1982-1984=100)	2.6	3.1	3.5	3.9	3.8	
<b><i>Employment</i></b>						
Total Nonfarm	-0.5	0.3	0.9	1.1	0.6	
Manufacturing	-6.2	-3.9	-2.9	-3.3	-2.4	
Private Service-Providing	0.2	0.6	0.8	1.8	1.0	

1. 2006 forecasted by the NJCEA.

2. CPI for NY-NJ-CT-PA metropolitan area.

3. Employment figures for 2001-2006 are seasonally adjusted December totals.